

Section 9- Earned Income Tax Credit (EITC)

Earned Income Tax Credit (EITC) Still Available for Working Taxpayers

The EITC is a refundable tax credit for people who work and have earned income from employment or self-employment below established amounts. Dollar amount limitations are adjusted for inflation each year. The credit reduces the amount of taxes owed and may also provide a refund. The EITC is available to anyone who qualifies for the credit and files a federal income tax return (even if no tax is due). To qualify for the EITC, taxpayers must have earned income during the year. Married taxpayers who file a joint return may qualify if at least one spouse has earned income. Earned income includes all taxable wages, salaries, and tips and all net earnings from self-employment. Some taxpayers may be eligible to claim the EITC for the first time, especially if there were changes in the family such as a new child, divorce, or decrease in earnings during the past year.

To claim the EITC, all taxpayers must meet the eligibility requirements below:

- Must have a valid social security number (SSN) issued by the Social Security Administration (SSA);
- Cannot file as “married filing separately;”
- Generally, must be a U.S. citizen or resident alien all year;
- Cannot file Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion;
- Cannot have investment income in excess of \$2,600 (tax year 2003); and
- Cannot be a qualifying child of another person.

For the taxpayers to be eligible for the EITC with a qualifying child, the child must meet relationship, age, and residency tests. If a child is a qualifying child of more than one taxpayer, they can choose who will use that child to claim the EITC.

A correct and valid SSN must be provided for each qualifying child listed on Schedule EIC, unless the child was born and died during the tax year. File Form SS-5 with the SSA if an SSN is needed.

To be eligible for the EITC without a qualifying child, your client:

- Must be at least age 25 but under age 65 at the end of 2003;
- Must not qualify as the dependent of another person;
- Must have lived in the United States for more than half the year.

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Earned income generally means wages, salaries, tips, and other taxable employee compensation and net earnings from self-employment. Whether a client can claim the EITC for 2003 depends on your client's filing status, earned income, and AGI. His or her earned income and AGI must each be less than:

Filing Status = Single, Head of Household, or Surviving Spouse

- \$33,692 with more than one qualifying child
- \$29,666 with one qualifying child
- \$11,230 without a qualifying child

Filing Status = Married Filing a Joint Return

- \$34,692 with two or more qualifying children
- \$30,666 with one qualifying child
- \$12,230 without a qualifying child

Advance Earned Income Tax Credit (AEITC)

The AEITC is available to taxpayers who expect to meet all of the eligibility requirements for the EITC and expect to have at least one qualifying child. It allows them to get part of the credit throughout the year in their paychecks. The AEITC can give taxpayers both a paycheck "boost" while they're working and a refund "bonus" when they file their return. There is no cost to employers. Employers reduce the amount of their required federal tax deposits by the advance payments and report the advance payments on Form 941. Taxes are not withheld from AEITC payments.

To request advance payment, a taxpayer must:

- Expect to have at least one EITC qualifying child;
- Expect to work and have earned income and adjusted gross income of less than \$29,000 (\$30,666 if your client expects to file a joint return);
- Have wages that are subject to Federal Income, Social Security, or Medicare tax withholding; and
- Expect to meet all the rules in the instructions for Form W-5 for the EITC for 2003.

An employee who meets these requirements and wants to receive advance payments should complete Form W-5, Earned Income Credit Advance Payment

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Certificate, and give it to the employer. Form W-5 contains additional information for married taxpayers, taxpayers with more than one job, and taxpayers whose situation changes during the year. Taxpayers who receive advance payments for 2003 **must** file Form 1040 or Form 1040A for tax year 2003, even if they do not owe taxes for 2003.

Earned Income Tax Credit – Frequently Asked Questions and Answers

Q1) What are the earned income and adjusted gross income (AGI) limits for 2003?

A1) Whether a client can claim the EITC for tax year 2003 depends on your client's filing status, earned income, and AGI. His or her earned income and AGI must each be less than:

Filing Status = Single, Head of Household or Surviving Spouse

- \$33,692 with more than one qualifying child
- \$29,666 with one qualifying child
- \$11,230 without a qualifying child

Filing Status = Married Filing a Joint Return

- \$34,692 with two or more qualifying children
- \$30,666 with one qualifying child
- \$12,230 without a qualifying child

Up-to-date information on eligibility requirements, due diligence, and more is available at www.irs.gov/eitc.

Q2) What are the most common reasons for disallowance of the EITC?

A2) Some of the more common reasons for disallowance are:

- Claiming the credit using a child who is not a qualifying child.
- Filing as single or head of household instead of married filing separately.
- Reporting incorrect income amounts.
- Entering incorrect social security numbers.

Q3) How can I determine whether a child meets the residency test?

A3) If you have any reason to question whether the child lived with the taxpayer for the required time period, you may find it useful to ask further questions.

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Additional questions might be necessary if, for example, the taxpayer states that the child lived with him or her for the entire year, but the taxpayer does not know the name of the child's school or care giver.

Q4) Must I review birth certificates to verify the age of the child?

A4) No. However, if you have reason to question the child's age, you may want to look at the birth certificate.

Q5) What can I do if I experience a significant number of rejects on electronically filed returns?

A5) If you experience a significant number of rejects, you should promptly discuss the situation with your local IRS Senior Tax Specialist in the Wage & Investment, Stakeholder Partnerships, Education and Communication Division, to identify and resolve any systemic problems. Call toll-free 1-800-691-1894 to locate the closest Tax Specialist.

Q6) What is EITC recertification?

A6) EITC recertification refers to the requirement that a taxpayer whose EITC is denied or reduced for a tax year starting after 1996 as a result of the deficiency procedures must establish eligibility to claim the EITC again. The recertification rules do not apply if the EITC was denied under the mathematical and clerical error procedures.

Q7) Is my client required to recertify when claiming the EITC for 2003?

A7) If the EITC was denied or reduced for a tax year after 1996, your client should have received Letter 3094 (Rev. 04/98), EIC Recertification Letter, from the IRS after the examination was completed. Letter 3094 explains the requirement to file Form 8862. Even though the taxpayer attaches a properly completed Form 8862 to the return for 2003, the taxpayer may still be required to furnish documentation before a refund is released. After the credit is disallowed and tax is assessed, you must generally attach a completed Form 8862, *Information To Claim Earned Income Credit After Disallowance*, to the next tax return on which the taxpayer claims the EITC. A Form 8862 is not required if

- Your client's EITC for 2002 was reduced or disallowed solely because the IRS determined that one or both of the children listed on the Schedule EIC was/were not the client's qualifying child(ren) for that year. In this situation, your client will attach Form 8862 to the first return he or she files claiming the EITC with one or more qualifying children; or
- Your client is claiming the EITC without a qualifying child for 2003.

Q8) Is my client prohibited from claiming the EITC for a number of years?

A8) Certain taxpayers may be prohibited from claiming the EITC for a two- or ten-year period. The prohibition may be imposed when the EITC claimed for a

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year after 1996 is denied or is reduced as a result of the deficiency procedures (upon examination), and the claim is determined to be due to reckless or intentional disregard of the EITC rules, or to fraud.

If the taxpayer's claim is due to reckless or intentional disregard of the EITC rules and regulations, that taxpayer will be prohibited from claiming the EITC for the next two years. As with the Form 8862 requirement, the first year of prohibition is the first year for which a return has not yet been filed. If the taxpayer is found to have fraudulently claimed the EITC, the taxpayer will be prohibited from claiming the EITC for the next ten years. In both situations, after the prohibition period is over, the taxpayer must attach Form 8862 to the next return on which the taxpayer claims the EITC.

Q9) What do I need to do to meet the due diligence requirements of Section 6695(g) of the Internal Revenue Code (IRC) when preparing a return or claim for refund with the EITC?

A9) Paid preparers of EITC returns and claims for refund (whether filed on paper or electronically) are expected to exercise due diligence in getting accurate information to determine eligibility and in correctly computing the EITC amount.

To meet your due diligence requirements, you must:

- Complete Form 8867, Paid Preparer's Earned Income Credit Checklist, or otherwise record the information necessary to complete Form 8867 in your paper or electronic files (alternative checklist);
- Complete the appropriate earned income credit worksheet in the instructions for Forms 1040, 1040A, or 1040EZ, or in Publication 596, Earned Income Credit. Otherwise, record the information necessary to complete the appropriate worksheet in your paper or electronic files (alternative worksheet);
- Have no knowledge or reason to know that any information you use in determining eligibility for, and the amount of, the EITC is incorrect; and
- Retain a copy of Form 8867 and the appropriate worksheet (or their alternatives) for three years after the June 30th following the date the return or claim for refund was presented to the taxpayer for signature.

A preparer may use electronic formats and may retain the records on paper or electronically. A preparer may not satisfy the knowledge requirements by ignoring the implications of information furnished to, or known by him. If any information furnished to, or known by the preparer appears to be incorrect, inconsistent, or incomplete, the preparer must make reasonable inquiries to resolve the matter and determine whether the taxpayer is entitled to claim the EITC or the proper amount of the

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EITC. If the preparer cannot resolve the matter, he or she must decline to prepare the return.

Q10) What is the effect of the tie-breaker rules on the due diligence requirements?

A10) Paid preparers are responsible for informing their clients about and applying the tie-breaker rules. The tie-breaker rules are applied when more than one taxpayer actually claims the credit based on the same qualifying child. When this occurs, the child is treated as the qualifying child of:

- The parent, if one of the taxpayers is a parent of the child;
- The taxpayer with the highest AGI, if none of the taxpayers is a parent of the child;
- The parent with whom the child lived the longest during the tax year, if two taxpayers are parents of the child and they do not file a joint return together;
- The parent with the higher AGI, if two taxpayers are parents of the child, they do not file a joint return together, and the child lived with both for the same length of time during the tax year.

If the preparer learns that another taxpayer with a superior right to claim the credit based on the child has already done so, or intends to do so, the preparer may not prepare the taxpayer's return without being subject to a penalty. However, if the taxpayer has the superior right, the preparer may prepare the taxpayer's return, even though the preparer knows that someone with an inferior right has already claimed the credit based on the child.

Q11) Must I use Form 8867, Paid Preparer's Earned Income Credit Checklist, as part of the due diligence process?

A11) No. It is not necessary to use Form 8867 to meet the preparer due diligence requirements. However, you must either use Form 8867 or otherwise record the information necessary to complete Form 8867 in your paper or electronic files. Your electronic record must meet the requirements of Revenue Procedure 97-22, 1997-1 C.B. 652.

Q12) Is there a penalty for not meeting the preparer due diligence requirements?

A12) Yes. Failure to meet the preparer due diligence requirements could result in a \$100 penalty for each failure under IRC Section 6695(g). However, you may avoid the penalty with respect to a particular return or claim for refund if you can demonstrate to the satisfaction of the IRS that, given all the facts and circumstances, your normal office procedures are reasonably designed and routinely followed to ensure compliance with the due diligence requirements

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discussed above, and the failure to meet due diligence requirements with respect to the particular return or claim for refund was isolated and inadvertent.

Q13) Must taxpayers and qualifying children listed on Schedule EIC all have SSNs?

A13) Yes. There are several types of taxpayer identification numbers that can be used when filing a federal tax return, but only an SSN can be used when claiming the EITC. However, if a Social Security card says “Not Valid for Employment,” and the cardholder obtained the SSN solely to get a federally funded benefit to which he or she is entitled, the SSN is not valid for EITC purposes.

Q14) How can I tell if my clients and their children have the right kind of SSNs?

A14) If the Social Security card does not contain the legend “Not Valid for Employment,” then the number can be used for EITC purposes. All U.S. citizens and all aliens granted permanent resident status are entitled to receive an SSN from the SSA. Aliens who do not have permanent resident status generally cannot get an SSN unless they are entitled to certain federally funded benefits. If an SSN is issued solely so that the individual can receive a federally funded benefit, the words “Not Valid for Employment,” appear on the front of the card.

Q15) Must I review Social Security cards?

A15) No. However, because the IRS uses SSNs to identify taxpayers, it is important that you explain to your clients that all names must appear on the return exactly as they appear on the Social Security card.

Q16) How can I avoid mismatches of SSNs?

A16) One of the primary reasons for the rejection of a return or a delay in processing a return is an incorrect SSN. It is important that you check the accuracy of each SSN, as well as the spelling of the name associated with the number. Ask if your client received a notice of an incorrect SSN for any prior tax year.

Q17) If there is a mismatch, what can I do to help?

A17) If the problem is not yet resolved:

- Have your client check the Social Security card for accuracy of the name and number on the return.
- Ask if a name or other change has been reported to the SSA.
- Determine if the problem was due to an error in recording or transcribing the number.
- Refer your client to the SSA to resolve the problem before filing a return if you cannot determine the problem.

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Q18) Where can I learn more about surname entry formats?

A18) A detailed discussion of surname entry formats can be found in Publication 1346, Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns. The specific references are in Part 1, Section 7 – Formats for Name Controls, Name Lines, and Addresses. If your software product “interprets” the name control from entries in the full name field, entries in the full name field should also conform to the name control format.

Q19) How do I report my suspicion if I think a client or another preparer is doing something questionable?

A19) As a tax professional, you have a vested interest (both as a taxpayer and as a tax preparer) in the protection of the tax filing system. Report your suspicions by sending an e-mail to the IRS Office of Refund Crimes at HQ-ORF@ci.irs.gov or by calling 1-800-829-0433. You can also file Form 211, Application for Reward for Original Information, if you want to be considered for a reward for information leading to the detection of violations of the IRC.